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# Supreme Court of the United States

OCTOBER TERM, 1939

No. 479

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

CHARLES A. BRUUN, RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### Opinion Below

The memorandum opinion of the Board of Tax Appeals (R. 30) is unreported. The opinion of the Circuit Court of Appeals (R. 43-46) is reported at 105 F. (2d) 442.

### Jurisdiction

The judgment of the Circuit Court of Appeals was entered on July 24, 1939 (R. 47). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

## Question Presented

Where a lessee constructs a building on leased premises under a contract which provides that the building shall be the property of the lessee during the life of the lease, but shall become the property of the lessor upon termination of the lease, and the lease is thereafter cancelled, does the lessor derive income in the year of the cancellation of the lease to the extent of the then value of the building?

## Statutes and Regulations Involved

The statutes and regulations are set out in the petition filed herein, pages 2 to 4.

## Statement

The facts, as stipulated (R. 13-30) and found by the Board of Tax Appeals (R. 30), are as follows:

On July 1, 1915, Charles A. Bruun, being then the owner of a parcel of improved real estate located at the southeast corner of Twelfth Street and Grand Avenue, Kansas City, Missouri, leased the same to Newmarket Investment Company for a period of 99 years (R. 14) running from July 1, 1915, and ending June 30, 2014 (R. 16). The lease provided for the payment of rent as follows:

> $5,000.00 upon the execution of the lease
> 1,000.00 a month to July 1, 1918
> 1,666.66 a month to July 1, 1922
> 2,083.33 a month to July 1, 1925
> 2,500.00 a month to July 1, 2014 (R. 17).

The lease required the payment of all taxes by the lessee (R. 18), and authorized the lessee to remove or tear down any buildings then, or which might thereafter be placed, upon the premises, provided it should first deliver to the lessor a bond guaranteeing the payment

of all rent and the performance of all the conditions of the lease for a period of two years after the beginning of the removal or demolition of such building or buildings (R. 20-21). The lessee was authorized, but not required, to place new buildings upon the premises (R. 20). The lease provided for forfeiture for failure to pay rent or taxes, and provided that no buildings should be removed from the premises or torn down after forfeiture (R. 21-22, 28), or after the year 2010 (R. 21). It provided that upon termination of the lease the lessee would "yield up to the first party the lands hereby leased with all buildings, improvements, fixtures and appliances situated thereon" (R. 28). The lessee went into possession and during the latter part of 1929 tore down the old building which then had a depreciated cost to the Respondent of $13,365.00, and prior to December 31, 1929, it constructed a new building upon the premises which had a useful life of less than 50 years.

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the Respondent went into possession of the property. The building thereon, which had been constructed by the lessee, had a value at that date of $64,245.68. The undepreciated cost of the old building torn down in 1929, amortized to July 1, 1933, was $12,811.43, which sum, when deducted from the $64,245.68, left a balance of $51,434.25 (R. 14). Neither this sum nor any part thereof was reported by the Respondent in his income tax return filed with the Collector of Internal Revenue at Kansas City, Missouri, for the year 1933. Upon auditing Respondent's return, the Commissioner added $51,434.25 to Respondent's gross income and determined a deficiency of $4,111.43 (R. 15).

The Board of Tax Appeals held that no gain was realized in 1933 (R. 30), and the Circuit Court of Appeals affirmed (R. 46). Petitioner seeks to bring the question thus presented to this Court for review.

## ARGUMENT

### I

### The Question Here Presented Has Received a Clear and Authoritative Answer

Petitioner contends (Pet. 5-8) that the question here presented has never received an authoritative answer, and he therefore requests (Pet. 10) that the petition be granted. We submit that Petitioner's premise is erroneous. Here, the lessee reserved the right to remove the building from the leased premises (R. 20-21). It was only upon "the expiration of the term of this lease either by lapse of time or by forfeiture" (R. 28) that the building was to become that of the lessor. It follows that simultaneously with the termination of the lease the building became a part of the realty (*Shelton* v. *Jones*, 66 Okla. 83, 167 Pac. 458; *Hughes* v. *Kershow*, 42 Colo. 210, 93 Pac. 1116), with the result that Respondent never acquired possession or control of anything other than improved realty. The result was precisely the same as though the building had at that time been placed upon the land by the lessee under a contract whereby it became the property of the lessor when constructed. Thus, the facts are in all material respects the same as those presented to this Court in *M. E. Blatt Co.* v. *United States*, 305 U. S. 267. In that case improvements were placed upon the land by the lessee under a contract whereby they immediately attached to the realty and became the property of the lessor. In holding that no gain resulted to the lessor at the time the improvements became his, this Court said (p. 279):

> Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor. So far as concerns taxable income, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was

an addition to capital; not income within the meaning of the statute.

Thus, this Court in unequivocal language has stated that even though improvements placed upon land enhances the value of the land, such value is not distinguishable from excess of value over cost of improvements made by the owner. Each is an addition to capital, and neither constitutes taxable income within the meaning of the statute. Language more decisive of the issue here presented could not well be employed. That this holding represented a part of the Court's decision and was not dictum is conclusively shown by the fact that Mr. Justice Stone unsuccessfully attempted to limit the Court's decision to another ground. It follows that the question which Petitioner seeks to present has received an authoritative and unequivocal answer.

This was the view taken by the Circuit Court of Appeals herein. It said (R. 46):

> While in the cited case [*M. E. Blatt Co.* v. *United States*, and others] the title to the improvements placed upon the leased premises by the lessee vested in the lessor under the terms of the lease at the time the improvements were made, whereas in the instant case title did not vest until the lease was terminated in a subsequent year, the principle is the same in all of them. The rule stated by the Supreme Court in the *Blatt Case*, *supra*, is controlling. No income was realized by the respondent in 1933 by reason of the cancellation of the lease.

In an effort to distinguish the holding in the *Blatt Company* case from the decision of the Circuit Court of Appeals herein, Petitioner says (Pet. 8):

> The decision below is a misapplication of *M. E. Blatt Co. v. United States*, 305 U. S. 267. There the lease was still in effect, and while the owner's property had been improved without expense to it, the lessee was presently in possession. This court held

(p. 280) that the owner "had no right to use or dispose of them [the improvements] during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute."

An examination of the *Blatt Company* decision will disclose that Petitioner does not correctly represent what this Court actually said. As we have pointed out above, it first held that the improvements were mere additions to capital, not income within the meaning of the statute. It then went on to say (p. 280):

> *But, assuming* that at some time value of the improvements would be income of lessor, it cannot be reasonably assigned to the year in which they were installed. The commissioner found that at the end of the term some would be worthless and excluded them. He also excluded depreciation of other items. These exclusions imply that elements which will not outlast lessee's right to use are not at any time income of lessor. The inclusion of the remaining value is to hold that petitioner's right to have them as a part of the building at expiration of lease constitutes income in the first year of the term in an amount equal to their estimated value at the end of the term without any deduction to obtain present worth as of date of installation. It may be assumed that, subject to the lease, lessor became owner of the improvements at the time they were made. *But it had no right to use or dispose of them during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute.* [Italics supplied.]

Thus, it will be seen that this Court first held that the improvements were additions to capital and not income within the meaning of the statute. It then went on to say that *even if it had taken a different view of the primary question,* nevertheless its decision would have been against the Government, for the reason which Petitioner now argues was the ground of the decision. However, inasmuch as the statement quoted by Petitioner

was based upon an assumption which had previously been found to be false, it is obvious that it was intended as, and was nothing more than, secondary or additional argument. It did not change the fact that the Court's primary reason for denying that income resulted to the lessor at the time the building was attached to the land was that "the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute." Accordingly, we submit that by lifting a sentence from its setting Petitioner has placed an erroneous construction upon what this Court actually held in the *Blatt Company* case.

## II

### There Is No Conflict in the Decisions with Respect to the Question Here Presented

Aside from the decision of this Court in the *M. E. Blatt Company* case, it has been held that where, as here, a lessee places improvements upon the land of the lessor during the term of the lease, no income results to the owner, either at the time the improvements are placed upon the premises (*Hewitt Realty Co.* v. *Commissioner*, (C. C. A. 2) 76 F. (2d) 880[1]), or upon the termination of the lease (*Miller* v. *Gearin*, (C C. A. 9) 258 Fed. 225, certiorari denied 250 U. S. 667; *Fifteenth Street Inv. Co.* v. *Nicholas*, (C. C. A. 10) 105 F. (2d) 289; *Cryan* v. *Wardell*, (N. D. Cal.) 263 Fed. 248; *Dominick* v. *United States*, (S. D. N. Y.) 24 F. Supp. 829; *Slack* v. *Commissioner*, 35 B. T. A. 271, appeal dismissed, *Commissioner* v. *Slack*, (C. C. A. 9) 91 F. (2d) 1011; *F. S. Stimson Corp.* v. *Commissioner*, 38 B. T. A. 303; and *Cleveland Trust Co.* v. *Commissioner*, 39 B. T. A. 113). There is no con-

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[1]Cited with approval by this Court in **M. E. Blatt Company v. United States, supra**, p. 279, Note 7.

trary decision upon the latter point, and this Court, in the *Blatt Company* case, definitely affirmed the *Hewitt Realty Company* case.

## Conclusion

The question here presented was clearly and unequivocally decided by this Court in its decision in *M. E. Blatt Co.* v. *United States*, *supra*. It was correctly decided by the Court below. In any event it has been squarely decided, contrary to the Petitioner's position, by other courts and the Board of Tax Appeals, and there is no conflict in any of the decisions. Accordingly, we respectfully submit that the petition for writ of certiorari should be denied.

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